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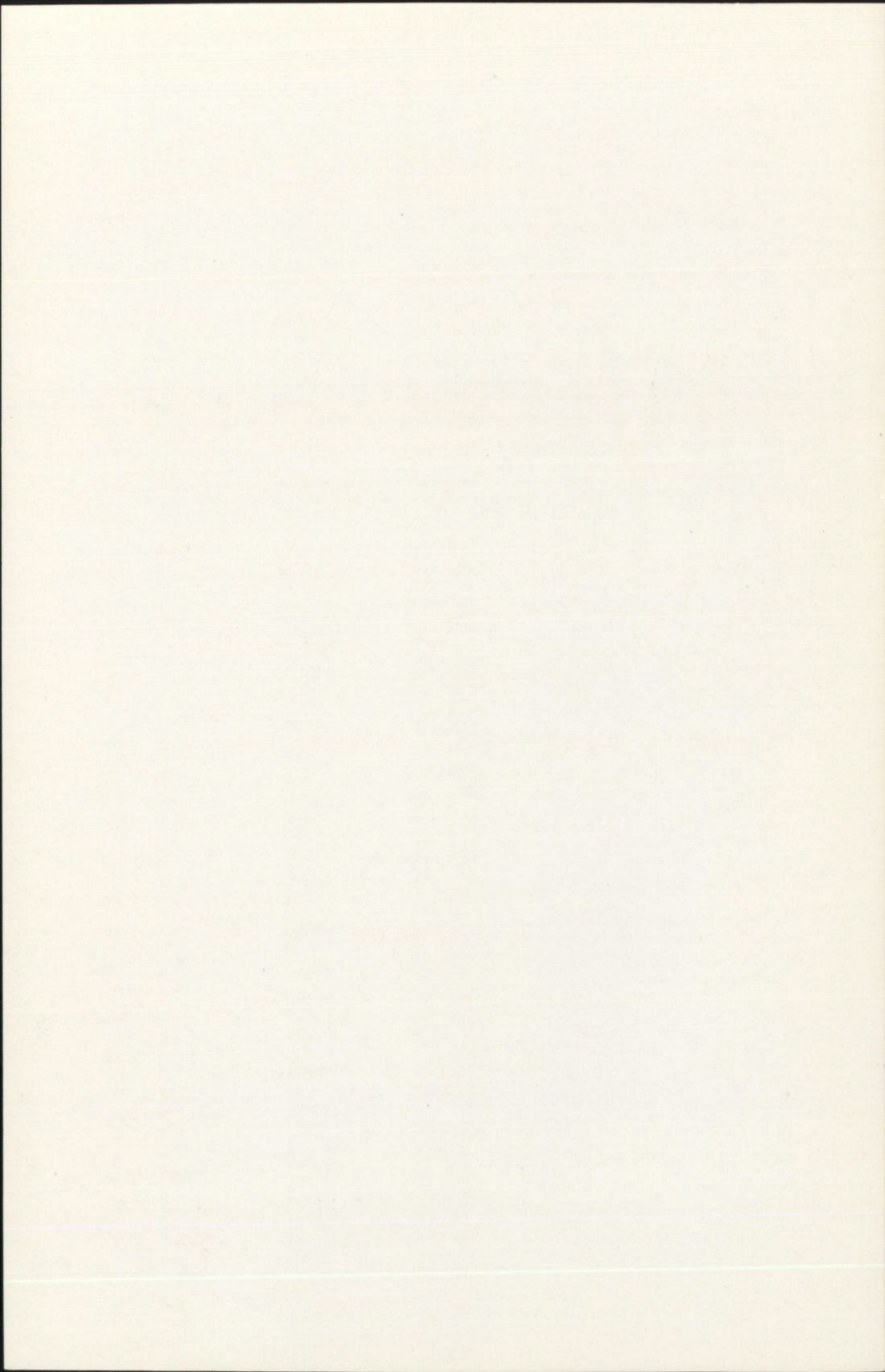


KAY

JEWELRY
STORES,
INC.

Annual Report

FOR THE FISCAL YEAR
ENDED JUNE 30, 1963



Dear Stockholder:

Allow me to call to your attention the page immediately following, on which you will find a graphic comparison of the financial statistics of the past three years of your Company, which should prove interesting.

From this you will notice in 1961 the Company lost \$589,000 of which \$373,000 was in the Leased Departments. In 1962 the Company lost only \$26,000 (the Leased Departments lost \$624,000, Kay Retail Stores having made up the difference). In 1963 your Company shows \$261,000 net profit after taxes while the Leased Departments lost \$601,000 (Kay Retail Stores and Subsidiary Corporations having made \$862,000). You can see, therefore, a net difference of some \$850,000 between the operation in the years 1961 and 1963. This 43-cent per share current net earning came about as a result of many changes in the operation of the business.

Prior to June 30, 1963 we liquidated and closed 11 Leased Departments. Since then we have closed an additional 13 Leased Departments. We have determined to operate the remaining 24 Leased Departments until January 1964, mainly for the purpose of obviating losses on inventory, as a goodly proportion of the residue will probably be sold during that period. Furthermore, there is a possibility that the remaining Leased Departments may break even or make some money between this writing and January 1964. In any event, any Leased Department that proves unsatisfactory or sustains a loss will be closed in January 1964.

Another loss that has been absorbed is in the Special Division of the Kay Company, which manufactures and distributes a home cleaning system. It has been operating 18 months and has lost this year some \$150,000 in operation and starting expenses. We feel this is not an unusual loss until the Division could habilitate itself. We believe that within the next 12 months this Division will turn in a reasonable profit.

With current business conditions as they are, the remedial effects of re-arranging our over-all business as to the Leased Departments and other expense curtailing will do much toward the continuing profit position of the Company. Furthermore, as in the past several years, Management has been closing loss operational Kay Retail Stores. In the last fiscal year, there were five non-profit Kay Jewelry Stores closed. Thus far in this fiscal year commitments have been made to open four Kay Jewelry Stores this fall in communities where we already have substantial successful investments, this is being done to protect those investments.

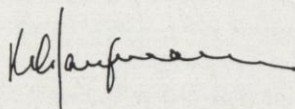
Furthermore, there is a possibility of a sizeable acquisition within the reasonable future.

Whenever a Kay Retail Store was closed, we had been most successful in collecting out or selling receivables and moving the inventory to another of our outlets; likewise, this is currently being done with the closed Leased Departments.

In order to permit the solicitation of proxies from stockholders for the Annual Meeting which is scheduled by the By-Laws for the fourth Wednesday in September in each year, your Board of Directors has postponed the Annual Meeting of stockholders from September 25, 1963 until November 25, 1963, and stockholders will receive due and formal notice thereof within the required time.

All in all, we feel very encouraged and look forward to a far more successful year profitwise than has currently transpired.

Sincerely,

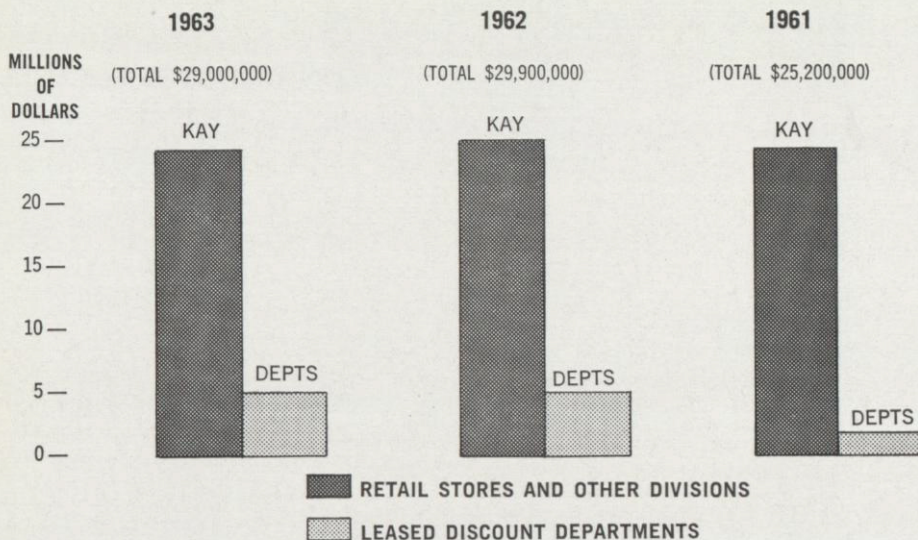
A handwritten signature in dark ink, appearing to read 'C. D. Kaufmann', with a long, sweeping horizontal stroke at the end.

C. D. Kaufmann, *President*

September, 1963

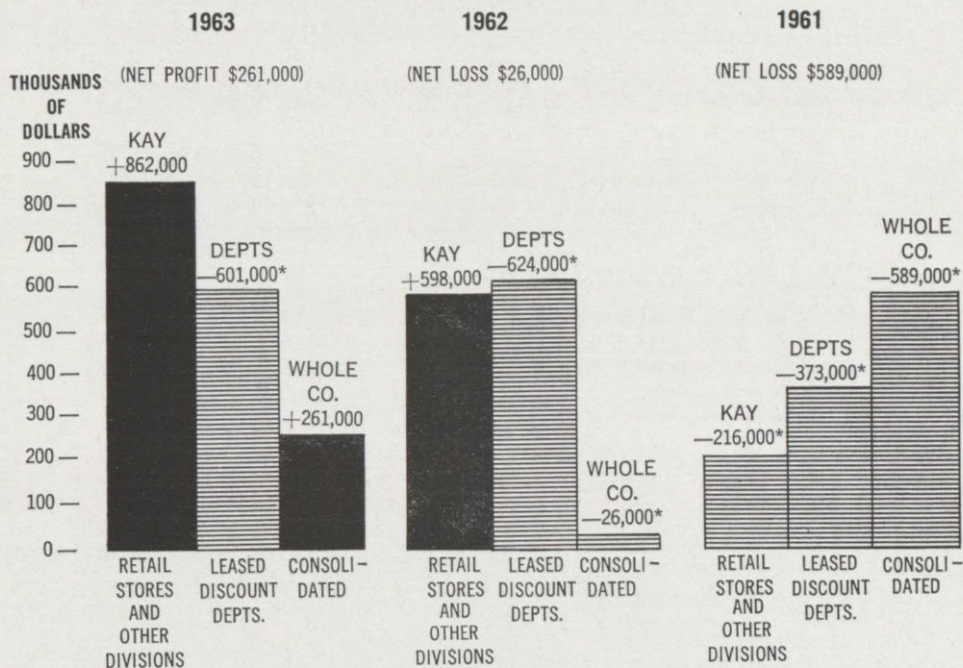
SALES AND OTHER INCOME

FISCAL YEAR ENDED JUNE 30



NET EARNINGS

FISCAL YEAR ENDED JUNE 30



* Red Figure

■ PROFIT ▨ LOSS

KAY JEWELRY STORES, INC.

CONSOLIDATED BALANCE

Assets

CURRENT ASSETS:

Cash	\$ 2,455,156	
Marketable securities		13,442
Accounts and notes receivable:		
Trade instalment balances (a portion of which is due after one year)	\$10,924,196	
Other trade accounts and notes	1,076,597	
	<u>\$12,000,793</u>	
Less allowances for doubtful balances and unearned service fees	788,800	11,211,993
Merchandise inventories, at the lower of cost or market, as determined principally by the retail inventory method		8,973,121
Prepaid expenses		226,819
TOTAL CURRENT ASSETS		<u>\$22,880,531</u>

OTHER ASSETS:

Investments in, and advances to, associated com- panies (Note A)	\$ 350,722	
Cash surrender value of insurance on lives of officers	231,154	
Unamortized discount on 5½% note	86,339	
Miscellaneous	<u>358,787</u>	1,027,002

PROPERTY AND EQUIPMENT—at cost: (Note B)

Land	\$ 50,000	
Building and building improvements	337,602	
Leasehold and leasehold improvements	1,291,647	
Furniture and fixtures	1,916,959	
Automobiles	<u>4,824</u>	
	\$ 3,601,032	
Less accumulated depreciation	<u>1,372,735</u>	2,228,297
		<u><u>\$26,135,830</u></u>

* Red figure

AND SUBSIDIARY COMPANIES

SHEET JUNE 30, 1963

Liabilities and Stockholders' Investment

CURRENT LIABILITIES:

Notes and loans payable:	
Banks	\$ 5,100,000
Current portion of long-term debt	357,000
Others	28,362
Trade accounts payable	1,917,585
Accrued salaries and interest	200,501
Federal and state income taxes (Note C)	299,445
Federal excise and other taxes	848,098
TOTAL CURRENT LIABILITIES	<u>\$ 8,750,991</u>

DEFERRED FEDERAL INCOME TAXES ON GROSS MARGIN (Note C)	994,158
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LONG-TERM DEBT:

5½% note payable due in equal annual instal- ments of \$350,000, less current portion (Note D)	\$ 3,600,000	
Mortgage payable on land, building and building improvements, interest at 4½%—payable in quarterly instalments of \$4,063 on account of principal and interest until maturity in 1976, less current portion (Notes B and H)	201,417	3,801,417

MINORITY INTERESTS IN SUBSIDIARY COMPANIES:

Preferred stock	\$ 25,976	
Common stock and surplus	1,106,638	1,132,614

STOCKHOLDERS' INVESTMENT:

Capital stock, par value \$1 per share (Note E):		
Authorized, 1,000,000 shares		
Issued, 599,260 shares	\$ 599,260	
Additional paid-in capital	10,086,530	
Retained earnings (Note D)	833,434	
Cost of 5,579 shares of capital stock held in treasury (deduction*)	62,574*	11,456,650
		<u>\$26,135,830</u>

See notes to financial statements.

**KAY JEWELRY STORES, INC.
AND SUBSIDIARY COMPANIES**

**CONSOLIDATED EARNINGS
YEAR ENDED JUNE 30, 1963**

INCOME:

Net sales (including \$1,863,476 to associated companies)	\$25,684,205
Service fees, dividends, interest, and other income	2,295,400
	<u>\$27,979,605</u>

COSTS AND EXPENSES:

Cost of sales (including buying and occupancy expenses)	\$17,345,905	
Administrative, publicity and selling expenses	9,847,355	
Interest expense	684,206	
Earnings applicable to minority interests in subsidiary companies	25,908	
Other	1,544	
		<u>27,904,918</u>
		\$ 74,687
Federal income tax credit, including reduction arising from liquidation of certain subsidiaries (Note C)		<u>214,900</u>
NET EARNINGS BEFORE SPECIAL ITEMS		\$ 289,587

SPECIAL ITEMS:

Loss on closing of certain discount jewelry departments, net of estimated insurance recovery (Note G)	\$ 161,296	
Deduct: Gain on sale of one-half interest in land and building, net of tax effect (Note B)	132,692	28,604
NET EARNINGS		<u><u>\$ 260,983</u></u>

See notes to financial statements.

**KAY JEWELRY STORES, INC.
AND SUBSIDIARY COMPANIES**

**CONSOLIDATED ADDITIONAL PAID-IN CAPITAL
AND RETAINED EARNINGS**

YEAR ENDED JUNE 30, 1963

ADDITIONAL PAID-IN CAPITAL:

Balance, July 1, 1962	\$10,095,214
Excess of cost over market value of common stock issued to store managers	<u>8,684*</u>
Balance, June 30, 1963	<u><u>\$10,086,530</u></u>

RETAINED EARNINGS:

Balance, July 1, 1962	\$ 572,451
Net earnings	<u>260,983</u>
Balance, June 30, 1963	<u><u>\$ 833,434</u></u>

* Red figure.

See notes to financial statements.

KAY JEWELRY STORES, INC. AND SUBSIDIARY COMPANIES

NOTES TO FINANCIAL STATEMENTS

The accompanying consolidated financial statements include the financial statements of Kay Jewelry Stores, Inc. and its majority-owned subsidiary companies.

A. Investments in, and advances to, associated companies:

The items included under this caption consist of loans (\$88,660) and investments (\$262,062) in the capital stock of 10 associated store corporations. The equity in the net assets of these store corporations amounted to approximately \$336,000 at June 30, 1963.

B. Property and equipment:

On June 18, 1963, 1328 Realty Company, Inc., a wholly owned subsidiary of Kay Jewelry Stores, Inc. sold, subject to an existing mortgage, an undivided one-half interest in the land, building, and building improvements located at 1328 New York Avenue, N.W., Washington, D. C. to the Kay Jewelry Stores Pension Trust for a total consideration of \$500,000. The gain realized from the sale, amounting to \$176,939 less applicable income taxes of \$44,247, has been reflected as a special item.

C. Federal income taxes:

Gross margin on instalment sales is taken into income at the time the sales are made, that is, on the accrual basis. Provision for federal income taxes is made on such gross margin, including that portion deferred for federal income tax purposes.

Federal income taxes are computed on an individual basis for each company included in the consolidated financial statements. When a company incurs a loss, a tax credit is recorded as a claim for refund of taxes paid in prior years or as an adjustment of deferred income taxes accrued in prior years. To the extent that such credits are not available, no tax effect of the loss is recorded in the current year. At June 30, 1963 companies included in the consolidation had accumulated losses aggregating \$715,000, which are available to reduce future years' taxable income.

On September 5, 1963 the Board of Directors of the Company approved the liquidation of five of its subsidiary companies which had substantial deferred income for tax purposes as of June 30, 1963. The effect of these liquidations on the loss carry-forwards of the parent was considered in the computation of the deferred federal income taxes as of June 30, 1963, reducing the provision previously established for federal income taxes by \$259,800. This reduction plus the carry-back of operating losses of subsidiary companies resulting in claims for refunds in the amount of \$143,700 accounts for the net federal income tax credit of \$214,900, after providing for tax liability for those corporations that have taxable income for the year.

D. 5½% note payable:

The loan agreement relating to the 5½% note payable contains certain restrictions relative to, among other things, the payment of cash dividends, purchase of the Company's capital stock and maintenance of consolidated current assets. As of June 30, 1963 the Company may not pay cash dividends on its capital stock.

E. Stock options and warrants:

The Company has granted five-year options to purchase 25,000 shares of the Company's common stock to the president of the Company. The option price is \$9.90 a share, 110% of the market price at the date of grant, July 13, 1962. Options to purchase 12,500 shares became exercisable on July 13, 1963, and the remainder become exercisable one year thereafter.

In connection with the arrangement for the 5½% note payable, five-year warrants to purchase 25,000 shares of the Company's capital stock were granted on January 31, 1959 to a non-affiliated corporation. The warrants were to be exercised in whole but not in part at a price of \$19.00 per share. Due to the subsequent issue of stock dividends, the warrants currently may be exercised for 26,010 shares at a price of \$18.26 per share.

On October 15, 1959, the Company adopted a restricted stock option plan for the benefit of employees. Under the employees restricted stock option plan, adopted in 1959, 35,000 shares have been reserved for issuance at a price which will be not less than 95% of the market value at the date of grant. At June 30, 1963 no stock options had been granted.

F. Long-term leases:

At June 30, 1963, companies included in the accompanying consolidated financial statements were lessees under 73 leases having terms of more than three years from that date with minimum annual rentals of \$939,000 plus, in some cases, real estate taxes and, in certain instances, increased amounts based on percentages of sales. No individual lease is deemed significant in relation to the enterprise as a whole, the highest minimum annual rental being \$71,000. 56 of such leases expire prior to June 30, 1973.

G. Loss on closing of certain discount jewelry departments:

Eleven discount jewelry departments operating in an unrelated chain of discount stores were closed during the year. Abnormal theft and damage losses were incurred because of the circumstances involved in the removal of stocks. A substantial portion of such losses are covered by insurance. Loss on operations of the eleven departments for the fiscal year beginning July 1, 1962, including abnormal losses and estimated insurance recoveries, have been reflected as a special item.

H. Contingencies:

District of Columbia income tax returns of the parent company for the years 1956 to 1961, inclusive, have been examined and deficiencies aggregating \$159,000 have

been proposed. The Company intends to contest the proposed deficiencies to the fullest extent possible. Inasmuch as it is impossible to predict the ultimate result of the proposal, no provision has been made in the financial statements for taxes and interest which would become payable if the proposal of the taxing authority is sustained. In the opinion of the Company and legal counsel the proposal is without substantial merit and legal counsel and the Company believe the final disposition should not have a material effect on the financial statements.

Federal income tax returns of the Company for 1960 and 1961 are presently being examined by the Internal Revenue Service. Preliminary discussions regarding this examination have revealed that tax adjustments may be proposed which would substantially exceed amounts provided therefor. The Company does not know the amount of the tax adjustment which will be proposed, but the Company and legal counsel believe that no significant liability will result therefrom.

1328 Realty Co., Inc., a wholly owned subsidiary of Kay Jewelry Stores, Inc., is primarily liable for the mortgage in the amount of \$416,834 on land, buildings, and building improvements leased to the parent company under a 15 year lease. This property is owned as a joint venture by 1328 Realty Co., Inc. and Kay Jewelry Stores Pension Trust.

CANADA	ITALY
UNITED KINGDOM	JAMAICA, W. I.
ARGENTINA	MEXICO
AUSTRALIA	NETHERLANDS
BAHAMA ISLANDS	NEW ZEALAND
BARBADOS, W. I.	PANAMA
BELGIUM	PERU
BRAZIL	PUERTO RICO
CHILE	RHODESIA
FRANCE	SOUTH AFRICA
GERMANY	SWEDEN
INDIA	SWITZERLAND
	VENEZUELA

TOUCHE, ROSS, BAILEY & SMART

CERTIFIED PUBLIC ACCOUNTANTS

September 9, 1963

CABLE ADDRESS: TROBAS

615 TOWER BUILDING
WASHINGTON 5, D. C.

Stockholders and Board of Directors,
Kay Jewelry Stores, Inc.,
Washington, D. C.

We have examined the consolidated balance sheet of Kay Jewelry Stores, Inc. and subsidiary companies as of June 30, 1963, and the related consolidated statements of earnings, additional paid-in capital, and retained earnings for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the accompanying financial statements present fairly the consolidated financial position of Kay Jewelry Stores, Inc. and subsidiary companies at June 30, 1963, and the consolidated results of their operations for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Touche, Ross, Bailey & Smart
Certified Public Accountants

KAY JEWELRY STORES, INC.

1328 New York Avenue, N.W. • Washington 5, D. C.

DIRECTORS

MARK A. FREEDMAN
BENJAMIN B. GOLDING
SIMON HIRSHMAN
HOMER A. JONAS
CECIL D. KAUFMANN
DONALD J. KAUFMANN
JOEL S. KAUFMANN

BARTLETT PINKHAM
(Associate: Allen & Co., New York, N.Y.)
HARRY J. RUDICK
(Partner: Lord, Day & Lord,
Attorneys-At-Law, New York, N.Y.)
HAROLD D. TRATTNER

OFFICERS

CECIL D. KAUFMANN, *President*
BENJAMIN B. GOLDING, *Vice President*
JOEL S. KAUFMANN, *Treasurer*
SIMON HIRSHMAN, *Secretary*
Auditors: TOUCHE, ROSS, BAILEY & SMART, Washington, D. C.

